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Analysis of Business Trends Plus Selected Financial Indicators

Interest Rate Jitters

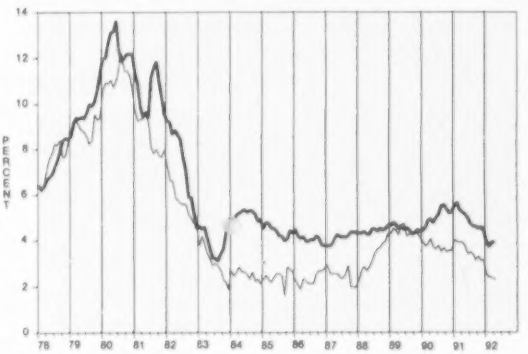
With the green shoots of recovery becoming more firmly rooted as spring unfolds, many analysts have turned their attention to the likely inflation and interest rate consequences. For although the inflation rate environment is becalmed at the moment and lackluster money supply growth keeps hopes of a further relaxation of monetary policy alive, the often harsh reality is that quickening economic activity is eventually—though not immediately—accompanied by rising price pressures and interest rates. As if this wasn't enough to worry about, the specter of an unbridled Federal government credit appetite clouds even further any sanguine interest rate expectations, especially in the bond market which has to repeatedly digest a relentless torrent of new Treasury offerings.

But whereas the odds of lower long-term interest rates do indeed lengthen with the release of firmer economic statistics and periodic announcements of forthcoming Treasury debt auctions, too much hand-wringing only encourages dry skin; a better tonic for emerging interest rate jitters is the likely persistence of today's inflation-friendly environment—which will not only retard the ascent of long-term rates but, by enabling the Federal Reserve to maintain its current monetary stance, will corral short-term interest rates for the foreseeable future.

Economics Department 17/270

Judging by the most recent inflation rate statistics, the Federal Reserve possesses the flexibility to not only maintain its present policy posture but, if it so desires, to ease further. According to the Labor Department, producer prices edged up by a modest 0.2 percent in April month-over-month, and by a similar amount when the volatile food and energy components are excluded (see chart). This brings the 12-month rise in producer prices for finished goods to just 0.9 percent, a dramatic ebbing of price pressures compared with the 3½ percent gain in producer prices recorded during the year ending April 1991—when the economy began to emerge from recession—not to mention the nearly six percent rate of producer price inflation prevailing in early 1990. Nor is the good news behind us. Snaking back up the production chain, producer prices for intermediate goods have actually dropped slightly during the past year while prices for crude goods have dipped by two percent over the past 12 months.

CPI LESS FOOD & ENERGY (THICK)
VS. PPI LESS FOOD & ENERGY (THIN)
(12-MONTH PERCENT CHANGES)



Source: Bureau of Labor Statistics

Consumer prices, too, have been favorably affected by the economy's softness as well as the vigorous cost-shaving efforts of corporate America. Consumer prices rose by a modest 0.2 percent in April month-over-month and, despite periodic blips in prices for such items as apparel and entertainment, and the relentless escalation of medical costs, they are up by just a shade more than three percent over the past year. Perhaps more persuasive that today's inflation relief will extend well beyond the initial stages of recovery is the ebbing of employment costs, both wages and benefits. During the year ending in March, wage costs, which account for some 70 percent of employer compensation costs, rose by 3.4 percent, the slowest annual rise since the first quarter of 1988, and far slower than the pace of wage increases registered during the year immediately following the steeper 1973-75 and 1981-82 business downturns. And, some of the steam finally seems to be coming out of the rapid escalation of employer benefit costs. These rose 6.3 percent during the year ending in March 1992—still high, but not quite as rapid as the nearly 7¼ percent rate of rise recorded during the year ending in the first quarter of 1990.

False Readings?

While actual and potential inflation rate developments should be sufficient to keep the monetary policy tightening enthusiasts at bay, so should M2 money supply developments. Virtually every Fed official has, at one time or an-

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other, expressed dismay with the anemic growth of M2 and the potential threat its behavior poses to the sustainability of the current recovery. Sluggish M2 growth was cited as the justification for the latest round of ease initiated in early April. However, M2 growth still refuses to perk up. In fact, this monetary aggregate is now expanding even more slowly than it was a month ago—at a paltry one percent annual clip during the 13 weeks ending April 27 versus a nearly 3½ percent annual rate during the three months ending April 6.

But whether or not M2 trends are actually signalling an increasingly liquidity-starved economy crying out for more monetary ease, or are simply providing the policymakers with false readings is arguable. Consumer flight from low-yielding small certificates of deposits, an M2 component, into non-M2 assets is certainly extracting a heavy toll on M2 growth; staunching these deposit shifts, and re-igniting M2 growth may require higher, rather than lower interest rates. Perhaps the best course of action, however, is watchful neglect. The Fed can certainly take comfort in the more acceptable expansion of the exclusively transactions-related M1 money supply—up at an 11½ percent annual rate over the past 13 weeks, far faster than during the same period a year ago. With the econ-

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/29/92)	149,664	- 910	- 48,619
New York City (5/6/92)	27,008	+ 1,066	- 5,520
Commercial Paper (5/6/92)	551,806	+ 4,252	+ 140

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/29/92)	286,597	- 38	- 31,747
New York City (5/6/92)	49,821	+ 368	- 6,801

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/29/92)	1,014,622	- 1,710	- 44,689
New York City (5/6/92)	160,280	- 671	- 13,694

Financial Markets

	Friday 5/15/92	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	3.66%	- .03	- 1.88
180-Day Bills†	3.80	- .06	- 1.99
Longest Bills†	4.05	- .18	- 2.07
Recent Issues:			
5⅛s 4/30/94	5.06	- .20	
6⅞s 4/30/97	6.58	- .14	
7½s 5/15/02	7.27	NA	
8s 11/15/21	7.80	- .10	
Municipals:			
Bond Buyer—20 Bond Index* (5/14/92)	6.54%	- .10	- .40
Blue List Total ($ Million)	$1,161	- $ 89	- $ 108
30-Day Visible Supply ($ Million)	$5,247	+ $1,519	+$1,770
Total	$6,408	+ $1,430	+$1,662
Corporates:			
Moody's Aa Composite (5/14/92)	8.61%	- .11	- .57
30-Day Visible Supply ($ Million)	$1,969	+ $ 565	+$1,569
Stocks:			
Dow-Jones Averages:			
Industrials	3,353.08	- 16.33	+446.45
Transportation	1,374.07	- 25.59	+230.56
Utilities	212.01	- 2.00	+ 1.05
65 Stocks	1,188.38	- 11.20	+153.59
N.Y.S.E. Composite Index	226.31	- 2.89	+ 22.16
N.Y.S.E. Avg. Daily Vol. for Week (000's)	176,887	+ 3,222	+ 4,947

*34% Taxable equivalent 9.91%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/15/92	Week Ago
Overnight	3.88%	3.69%
1 month	3.75	3.75
3 month	3.81	3.88
6 month	3.94	4.06
1 year	4.38	4.50

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/15/92)	Currency Per U.S. $	Week Ago
Belgium	33.29	33.52
Canada	1.2088	1.1995
France	5.4314	5.4656
Germany	1.6179	1.6320
Italy	1217.72	1228.53
Japan	130.35	132.70
Mexico	3083.51	3082.50
Netherlands	1.8209	1.8350
South Korea	736.97	763.97
Switzerland	1.4845	1.5125
Taiwan	24.66	24.77
U.K.*	1.8174	1.8028

*U.S. $ per U.K. pound

CHEM TRADE-WEIGHTED DOLLAR (5/15/92) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	-0.1%	-18.8%

omy firming, Fed caution may be the prudent policy course, for it may not be too long before the bond market shifts its gaze from M2 to M1, and questions the appropriateness of sustained, double-digit M1 growth rates.

Washington Excess

If the prospect of an inactive monetary policy is a prescription for stable short-term interest rates, an overly active fiscal policy threatens the stability of long-term interest rates. During the first half of the current fiscal year, the Federal deficit surged to a whopping $197 billion, and the outlook for the entire fiscal year is for the red-ink total to approach $400 billion. Treasury borrowings could top $150 billion during the April-September period, with the bulk of the new debt offerings bunched in the summer months.

As a result of Washington's excesses, there is a renewed movement afoot to implement some type of balanced budget amendment (BBA). But whether or not the current BBA proposal is a step forward or an election year canard is questionable: Lacking clear-cut enforcement provisions and doing little to limit spending, Congress could be cooking up little more than a back door tax increase of Herculean proportions—hardly the recipe for enduring economic prosperity.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/13/92	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	275.227	+ 2.608	+25.415
Loans to Depository Inst.	.195	+ .087	- .126
Float	.266	- .661	- .020
Total Reserve Bank Credit	307.302	+ 2.424	+20.135
Treasury Deposits with Federal Reserve Banks	5.012	- .239	+ .081
Currency in Circulation	307.803	+ 1.174	+19.139
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	273.754	+ 3.440	+28.475
Member Bank Reserves:	**5/13/92**		
Total Reserves Held	57.113	- 1.772	+ 7.675
Excess (Deficiency)	.541	- .695	- .429
Net Free Reserves	.389	- .733	- .395
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (5/4/92)	951.7	+ 13.8	+ 12.1
M2 (5/4/92)	3,471.0	+ 1.9	+ 2.1
M3 (5/4/92)	4,178.8	- 0.3	+ 0.2
Domestic Nonfinancial Debt (4th Q'91)	11,229.1	+ 5.3	+ 4.4

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 5/15/92	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	3.53%	3.65%	3.87%
* Federal Agencies	3.70	3.80	4.15
* Municipal Notes–High Grade (34% Taxable Equivalent)	4.55	4.70	4.92
Negotiable Time CDs Chemical	Rates By Arrangement		
* Secondary Market–Prime	3.75	3.90	4.30

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	3.83%	Jun.	3.66%
15- 29 days	3.78	Jul.	3.66
30- 59 days	3.75	Aug.	3.66
60- 89 days	3.70	Sep.	3.70
90-179 days	3.74	Oct.	3.75
180-239 days	3.83	Nov.	3.75
240-270 days	3.83		

‡ Industrial Paper–Prime			
30- 89 days	3.89%	†Federal Funds Effective Rate	4.00%
90-120 days	3.87		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross Domestic Product (Current Dollars)*	1st Q'92	$ 5,809	$ 5,740	$ 5,589
Gross Domestic Product (1987 Dollars)*	1st Q'92	$ 4,892	$ 4,868	$ 4,824
Percent Change, Annual Rate	1st Q'92	2.0	0.4	- 2.5
Change in Consumer Prices*	Apr '92 n	2.4%	6.0%	2.4%
Change in CHEM Cost of Living Index*	Apr '92 n	9.6%	6.0%	7.2%
Change in Producer Prices*	Apr '92 n	2.4%	2.4%	2.4%
Civilian Employment (Thousands of Persons) †	Apr '92 n	117,675	117,348	117,388
Unemployment as % of Civilian Labor Force †	Apr '92 n	7.2%	7.3%	6.6%
Personal Income*	Mar '92	$ 4,990	$ 4,963	$ 4,781
Leading Indicators Composite Index (1967=100) †	Mar '92	147.9	147.6	141.5
Industrial Production Index (1977=100) †	Apr '92 n	108.2	107.6r	105.5
Net Change in Consumer Installment Credit †	Mar '92 n	- $ 1.61	- $ 0.47	- $ 0.32
U.S. Merchandise Trade Balance †	Feb '92	- $ 3.38	- $ 5.95	- $ 5.50
Plant and Equipment Expenditures*	2nd Q'92	$ 557.5 (a)	$ 545.0 (a)	$ 524.6
Private Housing Starts (Thousands of Units)*	Mar '92	1,365	1,283	918
New Construction Expenditures*	Mar '92	$ 419.9	$ 413.3	$ 401.9
Total Business Inventories †	Mar '92 n	$ 816.3	$ 813.2r	$ 818.5r
Total Business Sales †	Mar '92 n	$ 547.9	$ 545.4r	$ 523.5r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

It's a challenge to the competition and a work ethic here at Chemical Banking Corporation.

It pledges: be effective enough to make yourself indispensable to your customer; anticipate trends that benefit your customer; create products and services that are fresh and new.

It says don't take relationships for granted, an important credo because we're first on so many fronts: first in primary relationships with U.S. corporations, first in loan syndication worldwide and first in serving middle market companies, for example.

At Chemical the raw materials of innovation are capital strength combined with intellectual currency.

A recent equity offering—the largest ever for a U.S. commercial bank—added more than $1.5 billion to our already strong capital base. And we intend to continue building it.

Intellectual currency is the intelligence, ingenuity, drive and knowledge our people use to meet clients' financial needs.

We use intellectual currency and capital strength to innovate across all markets and all functions. If you are a customer of ours, or if you become one, hold us to our pledge. We'll help you innovate so you can leave your competition in your wake.

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